

## **Consulting Advice on Investigations into Possible CEO Misconduct**

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### **Abstract**

This paper sets out for fellow consultants: (i) internal controls to avoid a client's hiring of a chief executive officer (CEO) who may have had a past or current instance(s) or pattern of misconduct; (ii) the forms of possible misconduct of a CEO; (iii) the component steps and process to follow in investigating such misconduct; and (iv) respecting a CEO's procedural rights during the investigation.

This paper provides consultants with content upon which to advise during their practices, including their advice to organizational clients, senior management, and boards of directors.

## Introduction

The most important job of any board of directors (board) is to hire and fire the CEO. The most common regret that directors have expressed to me is not firing the CEO sooner. This article focusses on investigating, and possibly terminating, a CEO for possible misconduct. What follows are best experiential practices for certified management consultants (consultants) to advise on possible CEO misconduct, within a North American context. I canvass the role of a consultant and board in overseeing an investigation.

CEO misconduct is rare if CEO selection is done properly, so many consultants and boards may not have to advise upon or oversee this issue. However, if or when possible, CEO misconduct is occurring, consultants and boards are best served by the process and steps set out below. The advice below is based upon my role as a consultant to boards and special committees and expert witness work involving CEO misconduct investigations. Lists are provided to enhance reading and content.

## Consulting Advice on Avoiding CEO Misconduct

The first step is to avoid possible CEO misconduct to begin with. The following mechanisms are all reasonable steps that a consultant and board may take to detect and mitigate against any possible CEO misconduct, at and beyond the hire stage by the Board:

- a. Reference, resume, background, integrity, criminal record, and social media checks prior to hire, for internal and external CEO candidates;
- b. A personality test (or behaviour and value testing) of the incoming CEO by an external search firm / industrial psychologist, prior to hire, for red flags, values, and cultural fit;
- c. Regular workplace culture surveys that measure toxicity, pressure, etc., with summary results provided to a committee of the board (committee) and board;
- d. Evaluation of the CEO that includes direct reports and certain stakeholders (e.g., 360), with CEO collaboration into the evaluation methodology and tool, and summary results reported to the committee and board;
- e. Just cause defined in a CEO's contract to include breach of the code of conduct, or a similar ethical conduct breach, with a fair process for making this determination;
- f. Meta data search of executives' emails to detect possible wrongdoing or misconduct, with legal compliance and notice of this data search;
- g. A clawback or behavioural gateway clause in the CEO's contract to include breach of ethical conduct or the code of conduct, with fair process, after which awarded cash or vested equity may become forfeited;
- h. An anonymous, communicated, remedied, and anti-retaliatory whistle-blowing policy, including at the executive level, so there is a greater likelihood that any potential wrongdoing by the CEO comes forward to the committee or board; and
- i. Retaining independent legal counsel to draft the CEO's contract on behalf of the board, with protections including just cause, termination, non-disparagement, non-

solicitation, non-competition, confidentiality, restrictions on outside activities, use of company assets, code of conduct, and other contractual mitigants of wrongdoing.

## **Possible Forms of CEO Misconduct**

The decision by a consultant to advise upon, or a board to oversee an investigation of, potential wrongdoing or conduct concerns of the CEO should be based on facts and evidence received or known by the consultant and board. Here are examples of CEO misconduct in no particular order. This listing is instructive for a consultant and board to view the various forms of CEO misconduct encountered.

- a. Alcohol, drug, or other substance abuse;
- b. Mistreatment of employees, including loss of temper, threats, swearing, intimidation, hostile work environment;
- c. Discriminatory behaviour, causing adverse career effects on other executives or employees, on any prohibited ground;
- d. Any type of dishonesty, that includes possible fraud;
- e. Any form of sexual misconduct;
- f. Expense account abuse, including payment of personal expenses, without knowledge of the board;
- g. Exceeding delegated transaction authority without knowledge of the board;
- h. Using company assets to benefit a family member(s) without board knowledge;
- i. Sharing of confidential information to benefit a family member(s);
- j. Recording of meetings and discussions, without knowledge of the board;
- k. Hiring or over-compensating a family member or another individual, without knowledge of the board;
- l. An extramarital affair by the CEO with another employee or a vendor without knowledge of the board;
- m. Association with an individual with a criminal past, and receiving such an individual on company premises;
- n. An adverse personal tax audit or finding without knowledge of the board;
- o. Cash payments used for certain transactions by the CEO, and a safe or cash room on company premises that contains cash with defective controls;
- p. Material disparagement of the chair and other directors by the CEO to other executives;
- q. Transmission of pornography on company computers and servers by the CEO;
- r. Taking advantage of corporate opportunity, for the CEO or a family member of the CEO, without board knowledge;
- s. Purchase of company assets (related party transaction) at under market price without board knowledge;
- t. Receiving inflated, above market compensation with knowledge of the board chair, or with knowledge of the board and compensation committee chair, but without knowledge or written approval of the committee or board;
- u. Providing consulting payments to the board chair by the CEO without board knowledge;
- v. Providing assets of the company by the CEO or the CEO's proxy to independent directors without shareholder knowledge or proper accounting treatment;

- w. Receiving consent from the board chair to take certain (illegal, high risk) action without knowledge of the board, or without any directors' knowledge;
- x. Not devoting full time and attention to the CEO's role and job description, without board knowledge;
- y. Knowingly falsifying a customs declaration record with knowledge of one committee chair, or a regulatory declaration without board knowledge; and
- z. Repeated, chronic related party transactions without board knowledge or independent review.

## **A Consultant Should Recognize the Red Flags**

There are "tells" and red flags that are revealed by actions, circumstances and body language when a CEO is possibly engaging in misconduct or lying to a committee or to the board. Consultants should be aware of these red flags. Some of these include, in no particular order:

- a. The CEO's behaviour changes to become more controlling and micromanaging of direct reports and accounting and financial reporting in particular.
- b. The CEO's behaviour changes to block access, progressively, to direct reports and information by the board or a committee.
- c. The CEO takes an unusually strong interest in director recruitment and governance.
- d. The CEO is the corporate secretary, or the corporate secretary is the executive assistant to the CEO.
- e. The CEO is strongly opposed to in camera sessions of only independent directors.
- f. There occurs the use of long serving and beholden consultants and other advisors and gatekeepers hired by the CEO and other executive management to provide support for executive action and shield board scrutiny.
- g. A long serving separate board chair and CEO with a personal relationship (e.g., friendship).
- h. Any advice received by the board, if at all, is funneled by the CEO, and the CEO heavily influences the selection of any advisor to be beholden to the CEO.
- i. Personal email is regularly used by the CEO and other executives for company business.
- j. There are weak controls over external and political activity, donations, and lobbying.
- k. The document retention policy for the company is not updated to current law or non-existent.
- l. The app Signal (or the equivalent) is used to communicate among senior executives (whereby the texts disappear after a certain time and are difficult to restore).
- m. There is a lack of financial literacy on the audit committee and board.
- n. There are long serving external auditors, and non-audit related services.
- o. The CEO and other senior management interact with board and committee chairs alone.
- p. The board or a committee chair, without board knowledge, or in some cases the entire board, regularly receive company perquisites.
- q. Transactions occur in high-risk, immature, or unregulated areas.
- r. The CEO blocks the board from seeing all relevant books and records.
- s. Management, with direction from the CEO, has drafted all governance documents.

- t. There is predominantly the use of PPT slides for updates and obtaining board approval.
- u. There are meetings (formal or social) involving the CEO, with certain directors deliberately excluded.
- v. The CEO prefers oral commentary to the board.
- w. The CEO has multiple affiliates, including a numbered company(ies) and offshore activities.
- x. There are a high number of non-arms-length, sole-sourced contracts, without board knowledge.
- y. Success or commission fees are paid without work product.
- z. The CEO displays microaggression, stress, defensiveness, or anger during board and committee meetings.

## **Consultant's Advice on Disciplining and Investigating a CEO**

Unethical conduct and other forms of wrongdoing normally occur in escalating progression by wrongdoers. A board is protected by the Business Judgment Rule, provided that the board exercises business judgment. Each director has a duty of care, which is to act as a reasonably prudent person would act under similar circumstances.

With CEO conduct, when red flags are observed, it is important for a consultant and the board to act in the immediate term. By not doing so, each signals to the CEO and other management what type of conduct is acceptable. There are steps that can be taken for progressive escalation attempts to cure the CEO's misconduct prior to approving a formal investigation. It is important for these escalating steps to occur to establish business judgment and a duty of care. A reasonably prudent person under similar circumstances would act when one or more of the red flags above are observed or detected.

A consultant and directors should assume that when they observe, read or hear of possible CEO misconduct, or red flags, this is precisely what an expert witness or regulator will see, read and hear when all books and records are produced in litigation or another adverse proceeding. In other words, it is a risk for a consultant or director to be of the view that inaction will not be detected in a later adversarial setting. Here are steps for progressive escalation of possible CEO misconduct upon which a consultant can advise and that a board can use prior to approving a formal investigation:

- a. An in camera session of independent directors to discuss concerns over the CEO's possible misconduct.
- b. A meeting between the board chair and vice chair (or two similar independent directors) and the CEO, with a note to file or letter to the CEO (or both) after the meeting.
- c. A collective discussion with the CEO at a board meeting, followed by or accompanied by a note to file or letter to the CEO, respectively.
- d. Formal coaching and development of the CEO, with the consultant selected by the board and regular written reporting on coaching sessions and progress, and likelihood of recidivism, provided to the board by the consultant.

- e. An immediate vacation of two weeks of the CEO, directed by the board, for mental health or rejuvenation.
- f. A letter of concern to the CEO from the board.
- g. A letter of reprimand to the CEO from the board.
- h. Termination of the CEO if the facts and circumstances are known or apparent to the board, and an investigation would not add anything substantive in the board's business judgment; and
- i. Approval by the board of a formal investigation into the CEO's possible misconduct.

## **When to Investigate?**

A criterion for advice by a consultant, or a decision by the board, to investigate a CEO's possible misconduct does not have to be a pattern of misconduct, but can be a single incident depending on the event or context. The materiality threshold to investigate should not be financial but reputational, which is broader in scope and normally with a lower threshold.

A threshold for an investigation may also be lack of knowledge by the board, and a desire for an independent investigation of the facts and rendering of an opinion, with which a consultant may assist.

I will now outline the importance of establishing a special committee early on when the possible misconduct becomes known to the board or consultant. A consultant should advise this special committee.

## **Consulting Advice on an Investigation of Possible CEO Misconduct**

Here are best practices for consulting advice and board oversight of an investigation into possible CEO misconduct:

- a. There should be an ad hoc special committee of the board (special committee) established by the board, composed of independent and disinterested directors possessing relevant and documented competencies to oversee the investigation into the CEO's possible misconduct.

A special committee is independent of management and has authority to commit resources, make payments, and direct interested parties (including management and the CEO and a director(s), as applicable) to stand down and discontinue inappropriate influence. A special committee is a different type of committee of the board than a standing committee. Many directors may, in their entire directorial career, never have served on a special committee, so it is important to receive proper and independent advice from the consultant from the outset.

A special committee that allows itself to be influenced by any interested party, or is not fully independent, or does not receive proper independent advice (e.g., independent consultant and, in no particular order and without limitation, a fairness, forensic, legal,

sexual misconduct investigatory, or valuation consultant, as the case may be), can be fatal to the findings and recommendations emanating from the special committee.

b. There should be an independent and disinterested independent advisor(s), including special independent counsel and an independent consultant(s), possessing relevant competencies, to assist and advise the special committee in the investigation of possible misconduct by the CEO.

c. Internal management counsel and external management counsel are not independent because they have a pre-existing employment, commercial, and advisory relationship with the CEO and company. The special committee should appoint special independent counsel to assist and advise the committee and draft the special committee's terms of reference. The terms of reference include the right to appoint a consultant(s) and instruct payments and retainers within a very short period of time given the cadence of a special committee, with summary support only provided to the finance department. Detailed time and activity logs containing references to research, work and advice provided to the special committee should be retained by the special committee until the conclusion of the investigation.

d. The special committee reports to the board (or, if or as applicable, a subset of the board containing independent and disinterested directors). The special committee or the board must not in any way participate in the investigation. The special committee has resources and autonomy to appoint consultants to undertake the required work and to report to the special committee. The special committee must remain independent from the investigative work being undertaken at all times and play a review and recommend role only. Otherwise, the special committee's independence may be challenged.

e. To the fullest extent practicable, to ensure the data integrity and confidentiality of the special committee and the investigation, the company's information systems (e.g., board portal, emails, virtual meeting technology, intranet, other) should not be used by the special committee or its consultants during the investigation. Special independent counsel should have such resources available, and provide them for the duration of the investigation.

f. A time frame for the investigation should not be promised or represented in advance or in any way by the special committee. If any time pressure by any interested party or any other party, including a shareholder(s), elected political leader(s), or a Counter Party with any interest in the outcome of the investigation, is exerted on the Special Committee, that Party(ies) should be directed by Special Independent Counsel to stand down. A Special Committee that has an accelerated time frame may be challenged on the basis of not fulfilling its Duty of Care. Courts have criticized Special Committees for not allocating proper calendar and meeting time.

g. Special independent counsel, in conjunction with the consultants, should instruct all relevant management and other employees to preserve all books and records and not take any adverse action against or communicate in any way with any prospective witness about the investigation, and advise on sanctions for not doing so.

- h. Special independent counsel should instruct all special committee members and other directors to take all reasonable steps to ensure confidentiality and integrity of the investigation and advise on sanctions for not doing so.
- i. Special independent counsel should take all reasonable steps to ensure that all interested parties do not possess any unauthorized information concerning the investigation.
- j. The consultant(s) should be afforded adequate time by the special committee to conduct the investigation, which will involve terms of reference, methodology, document reviews, witness interviews, findings, conclusions, and recommendations.

Each consultant(s) participating in the conducting of the investigation should be reviewed by special independent counsel for any relationship, direct or indirect, to the CEO or to any director, and their qualifications.

k. There may be additional consultants retained by the special committee, depending on the nature of the possible wrongdoing (forensic, fraud, transaction fairness, sexual misconduct, valuation, etc.), in the sole decision of the special committee, with advice from special independent counsel.

l. Special independent counsel includes lawyers within the special independent counsel's firm, who are retained as necessary to advise the special committee.

m. A special committee is labor intensive. If permitted under legislation or regulation, the chair of the special committee and other members should be fairly and reasonably compensated.

n. Special independent counsel, in conjunction with internal counsel and external counsel, should review and recommend to the board, as or if necessary, cooperation, anticipated credit, and disclosure to a regulator if there is an independent parallel regulatory investigation, on the special committee's and independent consultant's activities, findings, and reports. Generally speaking, a regulator looks favorably upon cooperation and a properly constituted special committee that is engaged in overseeing an independent investigation.

o. Legal advice should be provided to the special committee on whether part or all of the investigation is protected by solicitor-client privilege or litigation privilege, thus protecting external disclosure, if (i) legal advice was being provided by lawyers to the company during the course of, or with respect to, the investigation, and the company intended for this communication to be confidential; or (ii) it was reasonably expected or contemplated that litigation would ensue resulting from the investigation, e.g., the investigation is inherently adversarial. The facts learned during the course of an investigation are not privileged.

p. Management should cooperate fully with any and all requests for books and records in respect of the investigation made by the special committee, special independent counsel and the consultant(s) retained by the special committee.

q. Witnesses may be afforded the opportunity to meet with the consultant(s) outside of business hours, or otherwise, and away from company premises in order to preserve any anonymity granted by the consultant(s) or requested by witnesses, to insulate from possible adverse treatment and promote candor and disclosure. The consultant(s), in their report to the special committee, may redact a witness(es) name within the report to enhance the likelihood that adverse witnesses may come forward to be interviewed by the consultant.

r. The CEO may be instructed by the special committee to take a paid leave of absence during the investigation in order to enable real and perceived unimpeded access to books and records and witnesses by the consultant(s). The CEO may also be directed to preserve all books and records and not to contact any prospective witnesses. If the CEO takes a paid leave, which given the nature of the CEO's position is advisable, it should be clearly communicated to the CEO and employees by the special committee or board that no adverse inferences should be drawn by this absence. An acting CEO should be appointed by the board.

s. The CEO should be allowed to speak to the special committee and respond in writing to the special committee's report and consultant's(s') report, and to the board. The CEO should be allowed access to all relevant books and records to mount a full answer and defense.

t. Special independent counsel should not permit any interested party (including the CEO, other management, and management-retained advisors) to receive unequal, preferential and unfair treatment, as the case may be, by a special committee, and should promptly remedy any other defect or activities of the investigation or the special committee: in relation to interested parties; in relation to the confidentiality of information; in relation to the leadership, independence, competencies, and composition of the special committee; in relation to pressure or undue influence upon the special committee by an interested party(ies); and in relation to any lack of independent and disinterested consultant(s) to the special committee.

u. The board should be provided with complete reports and recommendation(s) of the special committee and any and all consultants (not summary reports) in advance of the meeting of the board to consider the results and recommendations of the investigation, and allowed time to read and digest such reports and recommendation, as the case may be, prior to review and approval by the board.

v. The board (independent and disinterested directors) should possess relevant information and key facts from a full independent investigative report prior to reviewing and approving recommendations made from the special committee.

w. The final report from the special committee to the board should be fulsome, substantive, and exhaustive, supported by committee member and independent review, analysis, and presentation.

x. The CEO and other management should be instructed to leave the room during all or parts of this report into possible CEO misconduct from the special committee and its independent advisors to the board.

- y. The consultant(s) should be instructed to leave the room during all or parts of this report, so those who remain in the room are the special committee and independent and disinterested members of the board.
- z. The above processes should require sixty to ninety days of calendar time.

## **A Consultant's Advice on the CEO's Procedural Rights**

The CEO's procedural and fairness rights must be protected throughout the entire investigation (special independent counsel will take all reasonable steps to ensure this). This is critical, and includes:

- a. The absence of interestedness and bias in the investigation, consultants, the special committee, and the board;
- b. That a complete and impartial investigation is carried out in a timely manner;
- c. That the CEO is provided with any and all allegations of possible misconduct in a timely manner;
- d. That access is provided to the CEO to required information in order to mount a full answer and defense;
- e. That the CEO is afforded adequate opportunity to be represented by counsel;
- f. That the CEO is provided with an ability to respond and present evidence, including, directly or indirectly, questioning adverse witnesses;
- g. That preliminary or interim findings or recommendations from the investigation, as the case may be, be kept in confidence during the investigation, and that no premature leaks or adverse findings to the media occur prior to the completion of the investigation;
- h. That the CEO is provided with the criteria upon which a decision is, will be, or was made;
- i. That the CEO is provided with all relevant information in advance of a recommendation and decision, including a copy of the report by the consultant(s);
- j. That the CEO be afforded adequate opportunity to speak to the special committee and to the board;
- k. That the CEO be provided with reasons in writing for a recommendation from the special committee or decision by the board, including the application of criteria to the facts;
- l. That a decision on the CEO's possible wrongdoing is reasonable on its face, applies criteria to facts, and is not arbitrary; and
- m. That the legitimate and reasonable expectations of the CEO were fulfilled.

## **Investigating CEO Misconduct: Implications for Consultants**

The foregoing process will ensure that, if or when possible, misconduct by the CEO occurs, a consultant should advise upon, and the board should take the appropriate steps to oversee an independent investigation and, in turn, advise upon and take necessary steps based on the results of this investigation, including termination.

Adopting the above steps by a consultant will protect any board and company, and provide procedural rights to the CEO whose conduct is being investigated. Certified management consultants, in adopting the above steps, will be well served to advise Boards on CEO misconduct investigations.

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